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In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 96

HAROLD T. WHITE, ALEXANDER M. WHITE, JR., and WILLIAM I. FROTHINGHAM, as Executors of the Estate of Alexander M. White,

Petitioners,

vs.

THE UNITED STATES.

No. 97

HAROLD T. WHITE, Sole Surviving Executor of the Estate of William A. White,

Petitioner,

vs.

THE UNITED STATES.

ON WRITS OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR PETITIONERS

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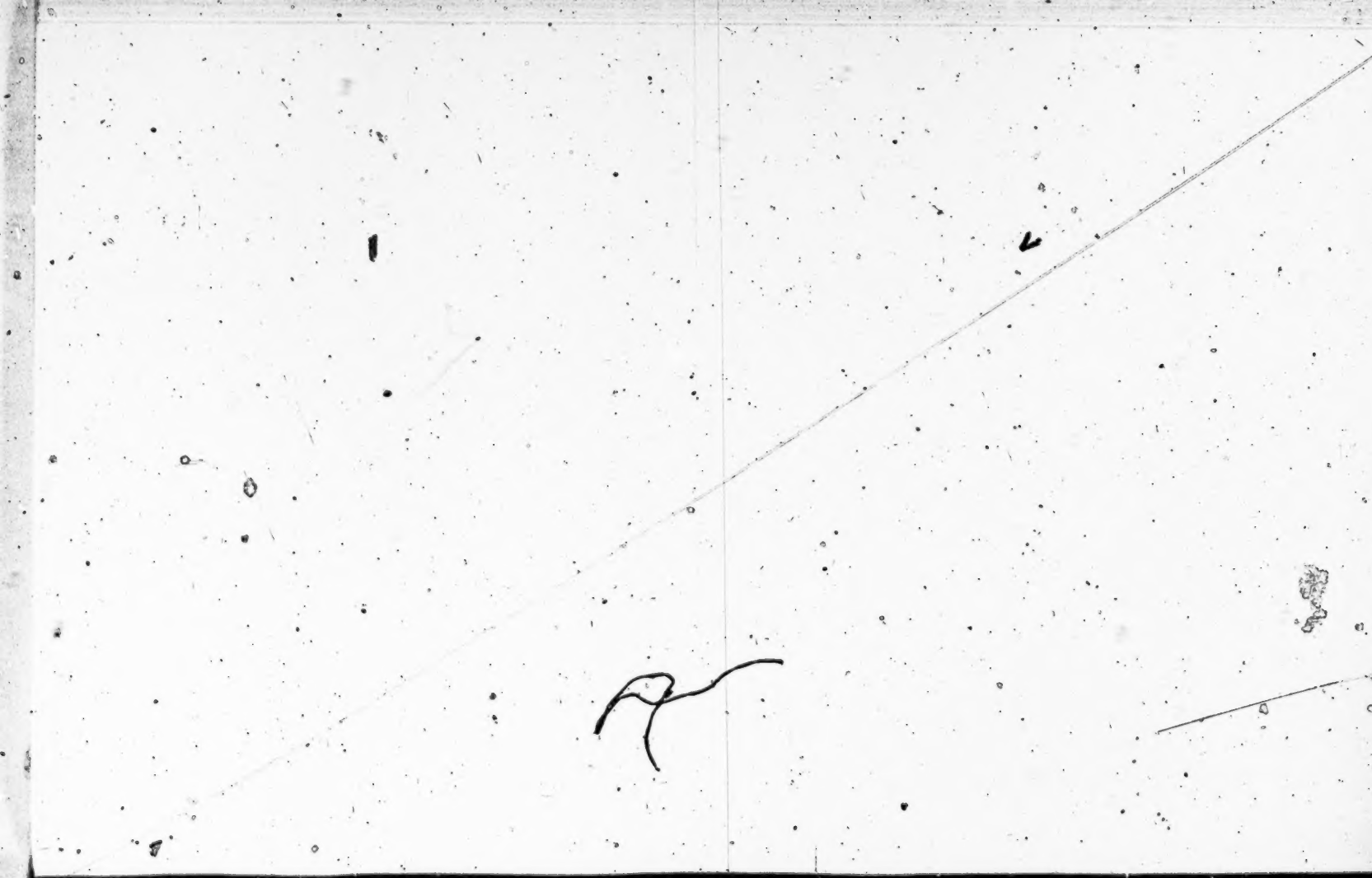

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OPINION BELOW

The opinion of the Court of Claims of the United States is reported in 21 Fed. Supp. 361 (R. 37-47).

JURISDICTION

The judgments of the Court of Claims were entered on December 6, 1937 (R. 47, 48). Motions for new trials in both cases on the grounds that there were errors of law in the judgments rendered on December 6, 1937, as stated in the Specification of Errors herein, were by a further order of the Court of Claims overruled on March 7, 1938 (R. 48).

This Court on October 10, 1938 granted the petition for writs of certiorari, which had been applied for on June 7, 1938 pursuant to 28 U. S. C., section 288(d).

QUESTION PRESENTED*

Whether admitted losses of $104,500 and $22,500 realized by the petitioners in 1929 on their Preferred Stock of Del-Bay Farms, Incorporated, a Delaware corporation, as the result of the complete liquidation of the said corporation in that year, are deductible to their full extent, or only to the extent of 12½% thereof.

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* Only the question stated was considered by the Court of Claims below and covered by the assignments of error herein. The conflict between the Court of Claims and the Circuit Court of Appeals for the Ninth Circuit, *Chester N. Weaver Co.* v. *Commissioner*, 97 F. (2d) 31, relates to the above question. The Government has, however, indicated in its Memorandum filed in response to petitioner's application for writs of certiorari that if certiorari was granted it would raise an additional defense in Docket No. 97, namely, that in the event of the reversal of the judgment of the Court of Claims in No. 97 no refund should be allowed in excess of $127.64 with interest thereon because of the bar of the statute of limitations, section 322 of the Revenue Act of 1928. If in the Government's answering brief it should seek to be heard upon this issue and the Court should be disposed, under the state of the record on this point, to consider such issue, the petitioner in Docket No. 97 is desirous of having the question of the sufficiency of its claim for refund for its full amount decided. In such event petitioner requests the privilege of filing a supplemental memorandum limited on such issue and will submit thereon without argument.

STATEMENT

In 1929 Alexander M. White owned 1,100 shares of the Preferred Stock of Del-Bay Farms, Incorporated, a Delaware corporation, which he had acquired at a cost of $110,000. The Estate of William A. White held 500 shares of said Preferred Stock which had been valued at $25,000 in the decedent's estate tax return in 1927 (R. 44, 46). In February, 1929, Del-Bay Farms, Incorporated, sold all of its assets, except its bank balances, and on April 11, 1929, was dissolved, its activities ended and its office closed (R. 43). Following this, a liquidating dividend of $5 was paid on each share of its Preferred Stock whereupon such stock became worthless (R. 43). Alexander M. White received $5,500 as a result of such distribution, thereby realizing a loss of $104,500, and the Estate of William A. White received $2,500, realizing a loss of $22,500 (R. 43, 46). Alexander M. White died on September 21, 1929 (R. 38). The stock certificates were never surrendered or transferred and the Executors of the estates of both decedents are still in possession of such certificates (R. 43).

The petitioners deducted the above losses in full in their returns for the year 1929 (R. 38-39, 45). The Commissioner of Internal Revenue notified the petitioners that there were deficiencies in their income taxes for the above periods and these deficiencies were paid and claims for refund filed (R. 38, 39, 40, 41). The Commissioner rejected the petitioners' claims for refund whereupon these actions were commenced in the Court of Claims (R. 39-40, 41).

The Court of Claims upheld the Commissioner concluding that, because of the payment by the Corporation of a small liquidating lividend, the losses realized by the petitioners on the Preferred Stock of Del-Bay Farms, Incorporated were capital net losses arising from a "sale or

exchange" deductible only to the limited extent of 12½%, rather than ordinary losses of capital investments deductible under section 23(e) in full from gross income. The Court of Claims conceded that, in the ordinary sense of the terms, there had not been a sale or exchange of capital assets. It held, however, that a "sale or exchange" comprehended a liquidation because of the provisions of section 115(c).

STATUTES INVOLVED

The relevant portions of the Revenue Act of 1928, c. 852, 45 Stat. 791, are, in view of the number and length of the sections involved, set forth in the Appendix.

Section 23(e).

Paraphrasing briefly the various sections involved, the Revenue Act of 1928 provides that petitioners' taxes are based upon "net income" computed at the rates provided in Subtitle B, Part I, of the Revenue Act of 1928. In turn, "net income" is computed under Part II, particularly section 21. Net income is there defined to mean "gross income computed under section 22, less the deductions allowed by section 23." Section 23(e) provides that in "computing net income there shall be allowed as deductions * * * losses sustained during the taxable year" not compensated for by insurance or otherwise "if incurred in any transaction entered into for profit."* Section 23(g) contains a

* Section 23(e) of the Revenue Acts of 1928 and 1932 deals with "Losses by individuals." The comparable section in such Acts dealing with "Losses by corporations" is 23(f). *Chester N. Weaver Co. v. Commissioner*, 97 F. (2d) 31, involves section 23(f) but dependent upon the Weaver Company decision are petitions for review filed from decisions of the Board of Tax Appeals in the cases of Chester N. Weaver and Elsie S. Weaver, individual taxpayers. Sections 23(e) and (f) are, it is believed, in so far as the present issue is concerned, comparable.

cross-reference to section 113 of Supplement B also dealing with the "Computation of Net Income" and which is stated to be "Supplementary to Subtitle B, Part II." Under such supplementary provisions in Supplement B, Part II, section 113, the cost basis for determining the amount of the deduction for losses sustained and to be allowed under section 23(e) is the cost of the property (in the instant cases $110,000 and $25,000, respectively). The amount of the loss deductible is the excess of the cost basis over the amount realized. The amounts realized from the sale or other disposition of the property here involved were $5,500 and $2,500, respectively. Consequently, the quantum of the losses allowable under section 23(e) is $104,500 and $22,500, respectively.

Section 115(c).

Section 115, found in the provisions "Supplementary to Subtitle B, Part II," provides that the "loss to the distributee resulting from" a complete liquidation of a corporation "shall be determined under section 111, but shall be recognized only to the extent provided in section 112."* Under section 111 the loss arising from the sale or other disposition of property is the excess of the basis provided for in section 113 over the amount realized. The amount realized from a sale or other disposition of property under section 111(c) is the sum of any money received plus the fair market value of the property other than money re-

* It is to be noted that section 22 "Gross Income" in subsections (d) and (e) makes specific direction to sections 115, 111, 112 and 113.

ceived. As the costs were $110,000 and $25,000 and the amounts realized were $5,500 and $2,500, the amounts of the losses were $104,500 and $22,500, respectively. The amount of the loss to be recognized is provided for in section 112, wherein it is stated that the entire amount of the gain or loss determined under section 111 shall be recognized except as thereinafter provided in said section. As applied to the instant cases none of the exceptions are applicable. Consequently, the entire amounts of $104,500 and $22,500 are recognized losses.

Section 101.

Section 101, found in provisions "Supplementary to Subtitle B, Part I," dealing with "Rates of Tax," has the effect of limiting a deductible loss resulting from the *"sale or exchange"* of capital assets to 12½% thereof. A "capital loss" is defined by section 101(c)(2) to mean deductible loss resulting from the *"sale or exchange"* of capital assets and section 101(c)(3) defines "Capital deductions" to mean "such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets *sold or exchanged* during the taxable year." The tax under the supplementary provisions in section 101(b) is computed upon *"capital net-loss (as hereinafter defined in this section)."* If, as petitioners contend, the loss suffered upon the Preferred Stock at the time of the complete liquidation of Del-Bay Farms, Incorporated was not a "sale or exchange", section 101 has no application to the instant cases.

SPECIFICATIONS OF ERRORS TO BE URGED

1. The Court of Claims erred in not following as controlling in these causes the decision of this Court in *Burnet* v. *Harmel*, 287 U. S. 103, after having conceded that in the "ordinary sense of the term" there was not a "sale or exchange of capital assets."

2. The Court of Claims erroneously concluded in its opinion and judgment that section 115(c) which makes reference to 111 and 112 but not to 101 is, nevertheless, to be read as broadening the defined term used in section 101(b) which by specific direction is thereinafter defined in 101(c).

3. The Court of Claims erred in holding that Congressional approval was expressed by the enactment of section 115(c) after interpretation by the Commissioner, since no part of Regulations 74, Article 625, makes reference to capital losses and since section 101(b) was amended so as to negative such construction.

4. The Court of Claims erred in construing section 115(c) as the result reached is contrary to the history and the purpose of the section.

5. The judgment rendered below is contrary to the provisions of section 23(e), the Court of Claims erring in making its opinion and judgment turn on a construction which ignored one of the three applicable sections.

SUMMARY OF ARGUMENT

Section 23(e) in unequivocal terms allows 100% of the losses realized upon petitioners' stock interest in Del-Bay Farms, Incorporated, at the time of its dissolution.

Equally unequivocal terms cannot be found disallowing to petitioners the full recognition or deductibility of any part of such losses. Section 115(c) literally and specifically directs the recognition of 100% of such losses. Assuming, *arguendo*, that section 115(c) is ambiguous, the doubt should be dissolved in favor of petitioners. Particularly as otherwise the receipt of a small final liquidating dividend leads to the anomalous result that the difference in tax may be many times the amount of the final liquidating dividend and that the receipt of nothing by the common stockholder makes him the preferred taxpayer.

Section 101 *per se* has no application to the question, as it deals only with "sales or exchanges." Both the Court of Claims in its opinion below and the Ninth Circuit in the *Weaver* case, although arriving at conflicting conclusions based upon the effect to be given section 115(c), concede that there was not in fact a "sale or exchange." No other conclusion, under the decisions of this Court, would have been tenable.

The argument proceeds under the separate errors specified.

ARGUMENT

I. The Court of Claims erred in not following as controlling in these causes the decision of this Court in *Burnet* v. *Harmel*, 287 U. S. 103, after having conceded that in the "ordinary sense of the term" there was not a "sale or exchange of capital assets."

A. Section 101 Deals Only With "Sales or Exchanges".

Section 101 standing alone on the facts found does not curtail petitioners' right to the full deduction permitted under section 23(e) because section 101 deals only with the tax computation in cases where there has been a "sale or exchange." Moreover, the carefully limited scope of the section is clearly indicated by the care taken to define the terms used therein. It is provided in section 101(b) that:

> "In the case of any taxpayer, other than a corporation, who for any taxable year sustains a *capital net loss (as hereinafter defined in this section)* * * *"

and in section 101(c) that:

> "(2) 'Capital loss' means deductible loss resulting from the *sale or exchange* of capital assets."

The parenthetical words of the first quotation above are new in the Revenue Act of 1928. Their literal and obvious meaning is to restrict the scope of section 101 to the definitions contained in the section, and they should be given that effect. For the same reason the words, "sale or exchange", cannot properly be given other than their ordinary and accepted meaning, even though it be assumed *arguendo* that they are differently defined elsewhere in the

Act. Moreover, Congress' deliberate choice of the phrase "sale or exchange" in contradistinction to "sale or other disposition" used in other provisions of the same Act shows a restricted meaning was intended.

B. Analogy to "Sales or Exchanges" Insufficient.

There was in the instant cases no sale or exchange in fact. There was not even a colorable sale or exchange of the Preferred Stock upon the liquidation. All that happened was that petitioners received cash. They did not even surrender their preferred stock certificates.* The dollars received merely constituted the payment and satisfaction of their obligations under the corporate charter according to its terms—a division of their remaining corporate capital.

The opinion of the Court of Claims below conceded that there was not in the ordinary sense of the terms a "sale or exchange". No other position would have been tenable. *Burnet* v. *Harmel*, 287 U. S. 103. The *Harmel* case presented the question whether profits derived from the granting of leases to oil or mineral properties construed under the state law to be a "sale in place" were

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* *Cf. Chester N. Weaver Co.* v. *Comissioner*, 97 F. (2d) 31, 32, where the preferred stockholders at the same time as the distribution surrendered their certificates. In Section 112(g) of the Revenue Act of 1928, Congress made a distinction in "reorganizations" based upon the absence of a surrender of the taxpayer's stock interest. It would seem that stock certificates were merely evidentiary. The dissolution of the corporation would appear to make the stock non-existent; thereafter the certificate would seem to be no more than an evidence of the right of participation in the division of the remaining corporate assets or capital. Since the negotiable character of the certificate and its readily salable value would be gone or very materially decreased, Congress had good reason for according a different treatment to gains or losses on liquidations than to gains or losses on sales or exchanges.

profits from "sales or exchanges". Although property rights were sold for cash, this Court refused to expand the meaning of "sale or exchange" to comprehend a lease for the reason that, generally speaking (the State laws of a few States to the contrary notwithstanding), such leases "would not generally be described as a sale" of the mineral contents of the soil, using the term either in its technical or in its commonly understood sense. To hold the contrary, this Court declared, would have been to adopt a distorted rather than the common meaning of the term "sale". In the words of Mr. Justice Stone writing for the Court:

> "Congress legislated in the light of this history, cf. *United States* v. *Merriam*, 263 U. S. 179, 187; and, in the absence of explicit language indicating a different purpose, it cannot be taken to have intended that an oil and gas lease under the capital gains provision, any more than a mineral lease under the earlier acts, should be treated like an ordinary sale of land or chattels, resulting in a conversion of capital assets. Such a construction would have disregarded legislative and judicial history of persuasive force; it would have adopted a distorted, rather than the common meaning of the term 'sale', see *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 561, and would have tended to defeat rather than further the purpose of the Act." [287 U. S. 103, 108.]

The mandate of *Burnet* v. *Harmel*, 287 U. S. 103, that the special treatment accorded by section 101 is limited strictly to the common meaning of the terms employed, can lead but to one conclusion. *Hellmich* v. *Hellman*, 276 U. S. 233, 237, holds that a distribution in liquidation is not a sale but *only analogous* to a sale: "The gains realized by the

stockholders from the distribution of the assets in liquidation were subject to the normal tax *in like manner as if* they had sold their stock to third persons." [Italics added.] *Burnet* v. *Harmel*, 287 U. S. 103, holds that a mere *analogy to a sale is not sufficient* to bring such analogy within the purview of section 101.

Likewise, it has been held that between the redemption of a bond and the sale or exchange thereof, there is a clear distinction, although the situations are analogous. *United States* v. *Fairbanks*, 95 F. (2d) 794. The government contended in this Court in opposing the taxpayers' petition for a writ of certiorari in the *Fairbanks* case:

> "The redemption and retirement of the bonds constituted neither a sale nor an exchange of capital assets, but payment, pursuant to call, of a fixed corporate obligation in accordance with its terms. The bonds on their face provided for their redemption at any time, at face value plus interest, upon notice to the registered holder thereof. The corporation so redeemed and thus extinguished its obligations.
>
> "None of the elements of a sale or exchange is present. There was no transfer of title; there was a mere payment of a debt, and return of the evidence of that debt. 'Sale' and 'exchange' connote a transfer of property to a new owner. Neither can be one-sided. There can be no sale without a purchase. There can be no exchange unless there be property parted with and property received by both parties. Certainly the corporation received no property for the cash it paid. The bonds it had issued were mere evidence of its obligation. *Commissioner* v. *Great Western P. Co.*, 79 F. (2d) 94, 96 (C. C. A. 2d), affirmed, 297 U. S. 543. Upon payment of the obligation, in accordance with its terms, that evidence was returned to the corporation."

Certiorari was denied in the *Fairbanks* case at this Term on October 10, 1938.

Petitioners' receipt of $5 per share on their Preferred Stock on the liquidation of the company certainly comes within the rationale of the government's position in the *Fairbanks* case. Under the constitutional provisions relating to impairment of obligations of contract, a corporate charter has long been held to be a contract. *Trustees of Dartmouth College* v. *Woodward*, 4 Wheaton 518. The payment of $5 to the preferred stockholders of Del-Bay Farms, Incorporated on liquidation was as much a payment in accordance with fixed terms as the payment involved in the *Fairbanks* case.

The contractual nature of the preferred stockholders' rights is clearly revealed by recent rulings of the Bureau of Internal Revenue under section 26(c) of the Revenue Act of 1936 relating to "Contracts restricting the payment of dividends". It has been ruled that the provisions in preferred stock certificates to the effect that no dividends shall be paid on the common stock while any of the preferred stock remains outstanding or while indebtedness in excess of a certain amount existed, constituted a contract restricting the payment of dividends entitling the corporation to a certain credit allowed in such cases. Internal Revenue Bulletin, January 17, 1938—No. 3, p. 3 (I. T. 3152, 1938-3-9144): To the same effect, Internal Revenue Bulletin, Cumulative Bulletin 1937-2, p. 111 (I. T. 3139, XVI-47-9049):

> "Inasmuch as *the contract with the preferred shareholders* was executed by the corporation prior to May 1, 1936, and expressly deals with the payment of dividends, and inasmuch as the required

number of its preferred shareholders refused to consent to the payment of a dividend, in stock or otherwise, on the common stock, *such contract* operated as a legal restriction, within the meaning of article 26-2(b) of Regulations 94, upon the corporation as to amounts which it could distribute as dividends within the taxable year 1936. Accordingly, it is held that the corporation is entitled to the credit provided by section 26(c) 1 of the Revenue Act of 1936 in the amount which, *except for the contract with the preferred shareholders* and their refusal to consent, could have been distributed as dividends on the common stock." [Italics added.]

The government has, likewise, successfully sustained the proposition that a so-called "purchase" of a retiring partner's partnership interest was not a "sale" or "purchase" so as to permit the cash gain to the retiring partner to be, at his option, taxable under Section 101(a) of the Revenue Act of 1928. *Helvering, Commissioner* v. *Smith,* 90 F. (2d) 590 (C. C. A. 2nd) reversed the Board of Tax Appeals.* The Second Circuit's opinion per Judge L. Hand, held:

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* The Memorandum Opinion of the Board is not officially reported. But see Commerce Clearing House, Inc., Board of Tax Appeals Service, Decision No. 9405-G. It was held: "The only question was whether $125,000 received by petitioner in 1930 as consideration for his interest in the law partnership of which he had been a member and from which he was then withdrawing was ordinary income, as the Commissioner determined, or capital gain as petitioner contended. There was no substantial dispute of fact, * * * At the close of trial the Division found the facts as stipulated and testified to and held as a conclusion of law, following *Dudley T. Humphrey,* 32 B. T. A. 280, that the Commissioner's determination erroneously treated the $125,000 as ordinary income and that it was capital gain as petitioner contended."

> "The transaction was not a sale because he got nothing which was not his, and gave up nothing which was." [90 F. (2d) 590, 592.]

This Court, in upholding the right of a minority stockholder to receive from the corporation the value of his stock in cash upon the dissolution of the corporation at the expiration of the term of its corporate existence, has found decisive the principles used in determining the rights of partners upon the dissolution of the partnership. *Mason* v. *Pewabic Mining Company*, 133 U. S. 50, 59:

> "We do not see that the rights of the parties in regard to the assets of this corporation differ from those of a partnership on its dissolution, * * *."

II. THE COURT OF CLAIMS ERRONEOUSLY CONCLUDED IN ITS OPINION AND JUDGMENT THAT SECTION 115(c) WHICH MAKES REFERENCE TO 111 AND 112 BUT NOT TO 101 IS, NEVERTHELESS, TO BE READ AS BROADENING THE DEFINED TERM USED IN SECTION 101(B) WHICH BY SPECIFIC DIRECTION IS THEREINAFTER DEFINED IN 101(c).

A. Sections 101 and 115 Are Mutually Exclusive.

The decision of the Court of Claims, in applying section 115(c) (found in Supplement B which is Supplementary to Subtitle B, Part II, relating to Computation of Net Income), so as to enlarge the scope of section 101 (found in Supplement A which is Supplementary to Subtitle B, Part I, relating only to Rates of Tax), raises a serious question of judicial legislation.

Sections 101 and 115 should not be construed together. They are mutually exclusive. Section 101 deals only with sales or exchanges as therein defined in that section. The

maxim *expressio unius est exclusio alterius* is clearly applicable:

> "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode."

Botany Mills v. *United States*, 278 U. S. 282, 289; *Paso Robles Mercantile Co.* v. *Commissioner*, (C. C. A. 9th), 33 F. (2d) 653, 654, certiorari denied 280 U. S. 595; *Anderson* v. *P. W. Madsen Inv. Co.*, (C. C. A. 10th), 72 F. (2d) 768, 770; *Martin* v. *Commissioner*, (C. C. A. 2d), 61 F. (2d) 942, 944.

The Court in *McFeely* v. *Commissioner*, 296 U. S. 102, has held that sections 101(c)(8) and 113(a)(5) are mutually exclusive and that "each section should be read as affecting the subject to which alone it applies." Fully as good reason appears for likewise concluding that sections 101 and 115 are mutually exclusive. Section 115(c) refers directly to section 111 which in turn makes reference to section 113. Sections 115, 111, and 113 are all found in Supplement B—Computation of Net Income—and are stated to be Supplementary to Subtitle B, Part II. Under the statutory scheme section 115 like 113 has no relationship to section 101 found in Supplement A entitled "Rates of Tax" and stated to be "Supplementary to Subtitle B, Part I" relating to "Rates of Tax". Part I and Part II of the General Provisions of the Revenue Act of 1928 are supplemented by Supplemental Provisions. The Committee on Ways and Means (Report, Committee on Ways and Means, No. 2, 70th Congress, 1st Session, p. 12) stated:

> "The General Provisions are divided into Parts. * * * In the main, the Supplemental Provisions are those which apply only to extraordinary classes of

taxpayers or which apply only to the extraordinary transactions of ordinary classes of taxpayers. The Supplemental Provisions are divided into Supplements."

It is clear that Congress in the new arrangement of the income tax title did not intend section 115 to be supplementary to section 101.

B. The Court Below Has Ignored the Second Sentence of Section 115(c).

The Court of Claims in its opinion, after quoting the first sentence in section 115 that "Amounts distributed in complete liquidation of a corporation shall *be treated as* in full payment in exchange for the stock, * * *" concluded:

> "The provisions of Section 115 make a liquidating dividend have the same effect as a sale or exchange of property."

But the second sentence of section 115(c) was omitted from the portion of section 115(c) quoted by the Court of Claims in its opinion and entirely disregarded. This disregarded second sentence directs:

> "The gain or loss to the distributee resulting from *such exchange* shall be *determined under section 111; but shall be recognized only* to the extent provided in section 112." [Italics added.]

The use of the phrase "*such* exchange" can only have been intended to invite attention to the same idea in the preceding sentence—"* * * *treated as* in full payment in *exchange* for the stock." To be "treated as" is not to be so in fact. The "treated as in full payment" was solely to distinguish a *liquidating* distribution from the definition of

"dividend" in section 115(a) and (b) which created a presumption that any distribution was out of earnings or profits to the extent thereof.

The omitted second sentence in 115(c) in a clear unequivocal direction states that the *"determination"* is to be under section 111—*not* 101. Moreover it is directed that the loss shall be *"recognized"* for tax purposes *"only"* to the extent provided in section 112*—*not* 101.** Again, as to section 115(c) the maxim *expressio unius est exclusio alterius* is applicable.

It is respectfully suggested that the court below has by judicial legislation made the sentence read:

> "The gain or loss to the distributee resulting from such exchange shall be determined under sections 111 *and 101,* but shall be recognized only to the extent provided in sections 112 *or 101, whichever produces the greater tax.*"

The court cannot enact a law under the pretense of construing one. As was said in *Heiner* v. *Donnan,* 285 U. S. 312, 331:

> "For this court to do so would be to enact a law under the pretense of construing one and thus pronounce itself guilty of flagrant perversion of the judicial power."

C. Cross Reference in Section 115(c) to 111 and 112 Adequate.

An application of section 115(c) according to its literal meaning is possible, sensible and adequate. As to the treatment of amounts distributed in the complete liquidation of a corporation, section 115(c) refers directly to section 111. The terminology of section 111 is:

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* 100% recognized.
** 12½% recognized.

> "*Except as hereinafter provided in this section,* the gain from the sale or *other disposition* of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the *loss shall be the excess of such basis over the amount realized.*" [Italics added.]

The reference to section 111 in section 115(c) allows the full quantum of the loss. The direct cross-reference in 115(c) and the introductory phrase in 111 shows an intent to *exclude* section 101 from consideration as to the percentage of deductibility recognizable. Literally both 115(c) and 101 are mutually exclusive. Both can be given their literal meaning and produce entirely sensible results. If the language be plain there is nothing to construe. *Hamilton* v. *Rathbone;* 175 U. S. 414, 419; *Thompson* v. *United States,* 246 U. S. 547, 551; see also Mr. Justice Roberts' dissenting opinion, Justices Brandeis and Stone concurring, in *Helvering* v. *N. Y. Trust Co.,* 292 U. S. 455, at 471:

> "Nothing could involve more dangerous consequences, than that the courts should rewrite plain provisions of a tax act in order to bring them into harmony with a supposed general policy."

D. Doubt to Be Resolved in Favor of Petitioners.

The very most that can be said for the Court of Claims' conclusion (R. 47) that sections 101 and 115 should be considered together is that it is a doubtful construction. *Chester N. Weaver Co.* v. *Commissioner,* 97 F. (2d) 31, 33. In which event, the rule announced in *Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552, 561 is applicable:

> "If there were doubt as to the connotation of the term, or another meaning might be adopted, the fact

of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer. *Gould* v. *Gould*, 245 U. S. 151; *United States* v. *Merriam*, 263 U. S. 179; *Bowers* v. *Lighterage Co.*, 273 U. S. 346; *United States* v. *Updike*, 281 U. S. 489; *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648."

Such a doubtful construction, therefore, should be rejected.

E. Decision Below Leads to Absurd Consequences.

The construction by the court below does violence to the literal meaning of sections 23(e), 101, 111 and 115(c) and produces the entirely unreasonable result that the receipt of 1¢ per preferred share, or a total of only $11, would make the tax $12,559.92 greater than if nothing at all had been received. On the literal construction of the sections contended for by the petitioners, the receipt of 1¢ per preferred share would make an increase in tax of only $2.53 over the tax computed if nothing were received, an amount commensurate with the additional income. Such additional tax then becomes comparable to the amount payable if there had been no distribution at all, the preferred stock having been entirely worthless. *Mont S. Echols* v. *Commissioner*, 61 F. (2d) 191 (C. C. A. 8th).

The Common Stock of Del-Bay Farms, Incorporated held by petitioners had admittedly become entirely worthless. The result of the Court of Claims' decision is that losses on the Preferred Stock are recognized only to the extent of 12½% while the losses on the Common Stock are recognized to the full extent thereof. The anomalous result is that the common stockholder thus becomes the preferred taxpayer. A small liquidating distribution is made to be more disadvantageous than no distribution at all. In

Chester N. Weaver Company v. *Commissioner*, 97 F. (2d) 31, 33, the Circuit Court of Appeals for the Ninth Circuit concluded that a construction producing such an anomalous result was to be avoided on the authority of *United States* v. *Katz*, 271 U. S. 354, 357, where it was stated:

> "All laws are to be given a sensible construction; and a literal application of a statute, which would lead to absurd consequences, should be avoided whenever a reasonable application can be given to it, consistent with the legislative purpose * * *."

It is significant that this Court has previously in construing section 101 placed emphasis on the dollar difference in tax under opposing constructions in *Helvering* v. *New York Trust Co.*, 292 U. S. 455, at 467, and footnote 4. Occasion was there taken to call attention to the fact that under the construction contended for by the Government the tax would be $252,667.66, whereas the tax under the taxpayer's contention would be $58,921.51. The conclusion was in favor of the taxpayer, the reason being given:

> "It is to be inferred that Congress did not intend penalization of that sort."

The same thought was again expressed in *McFeely* v. *Commissioner*, 296 U. S. 102, 111.

Congress declared in section 115(c) that reference should be made to 111. Congress said section 111 excludes, in determining losses, section 101. Congress has limited section 101(b) to capital net losses as therein expressly defined in 101(c) to be limited to "sales or exchanges". Notwithstanding, the court below has reached the surprising conclusion that section 115(c) broadens the carefully limited scope of 101 without making reference thereto, and thereby imposes a further qualification on the determination of amount

of loss under section 111 in spite of the express language in 111 to the contrary.

III. THE COURT OF CLAIMS ERRED IN HOLDING THAT CONGRESSIONAL APPROVAL WAS EXPRESSED BY THE ENACTMENT OF SECTION 115(c) AFTER INTERPRETATION BY THE COMMISSIONER, SINCE NO PART OF REGULATIONS 74, ARTICLE 625, MAKES REFERENCE TO CAPITAL LOSSES AND SINCE SECTION 101(b) WAS AMENDED SO AS TO NEGATIVE SUCH CONSTRUCTION.

A. No References to Losses.

The opinion below (R. 47) makes references to Article 625 of Regulations 74 as containing an administrative implication that section 115 makes "a liquidating dividend have the same effect as a sale or exchange of property." The relevant part of Article 625 referred to states:

> "Any *gain* to the shareholder may, at *his option*, be taxed as a capital net *gain* in the manner and subject to the conditions prescribed in section 101 and articles 501-503." [Italics added.]

It will be noticed first that nowhere in the Article is there any reference whatsoever as to what happens in the event of a *loss*. An absence of administrative interpretation apropos of the question for decision furnishes a novel hypothesis upon which to base a conclusion of implied Congressional approval through subsequent enactments.

B. Congressional Disapproval of Regulations by Changes in 1928 Act.

The opinion below concludes (R. 47):

> "Congress would seem to have approved the *Commissioner's interpretation* of the provisions of the 1924 and 1926 acts by *reenacting* them in the 1928 act." [Italics added.]

Even assuming *arguendo* that the Commissioner's Regulations had any interpretation apropos of the treatment of losses, Congress in the Revenue Act of 1928 rather than *reenacting* the section *in haec verba* removed all doubt upon the question by *amending* the provisions of the earlier 1926 and 1924 Acts. Article 1545 of Regulations 65 and 69 contained a cross reference (limited to *gains*) to section 208 of the 1924 and 1926 Acts. But this cross reference was disapproved in the 1928 Act—not by adding language to section 115 (as it was not needed there since as contended herein that section serves an entirely different purpose and is self sufficient) but by an addition to section 101 itself.

Revenue Act of 1928. [Section 101(b)]	*Revenue Act of 1926.* [Section 208(c)]
"In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss. (*as hereinafter defined in this section*), there shall be levied, collected, and paid * * *"	"In the case of any taxpayer (other than a corporation) who for any taxable year sustains a capital net loss, there shall be levied, collected, and paid * * *"

The phrase "(*as hereinafter defined in this section*)" was added for a purpose. It was added in both 101(a) and 101(b). The phrase excludes any other definition for "capital net loss". The clear intent of Congress should not be set aside by resort to a cross reference in Regulations under prior acts which have been disapproved and which do not even contain language literally covering the instant situation.

The rule announced by this Court in *McFeely* v. *Commissioner*, 296 U. S. 102, 111 applies:

> "Under these circumstances we ought not to depart from the plain meaning of the section in an effort to bring about a uniformity which it is claimed Congress intended but failed to express."

IV. THE COURT OF CLAIMS ERRED IN CONSTRUING SECTION 115(c) AS THE RESULT REACHED IS CONTRARY TO THE HISTORY AND THE PURPOSE OF THE SECTION.

Congress in the Revenue Act of 1913, passed shortly after the adoption of the Sixteenth Amendment, made dividends taxable as income at surtax rates. The term dividend was not defined. In such absence of a definition, the ordinary accepted meaning of the term dividend would not include liquidating distributions. In *Lynch* v. *Hornby*, 247 U. S. 339, 344, this Court held that a "dividend" by a going corporation out of pre-March 1, 1913, earnings was taxable:

> "In short, the word 'dividends' was employed in the act as descriptive of one kind of gain to the individual stockholder; dividends being treated as the tangible and recurrent returns upon his stock, analogous to the interest and rent received upon other forms of invested capital."

But the Court on the same day, June 3, 1918, decided in *Lynch* v. *Turrish*, 247 U. S. 221, that under the same Act the profit on a stock interest in a corporation was not taxable where it had been extinguished by the receipt of a liquidating distribution in an amount in excess of the cost of the stock interest. This decision the Treasury Department regarded as revealing a serious loop-hole in the law. As the Revenue Act of 1918 was then in the course of preparation what became section 201(c) of the Act was written into the bill. This provided that:

> "Amounts distributed in the liquidation of a corporation *shall be treated as* payments in exchange

for stock or shares, and *any gain or profit* realized thereby shall be taxed to the distributee *as other gains or profits.*" [Italics added.]

The Treasury Department and Congress were thinking only of insuring the collection of a tax upon any gain realized upon liquidations similar to those held not taxable in *Lynch* v. *Turrish*, 247 U. S. 221.† As "income" meant "'the *gain* derived from *capital*, labor or from both combined', provided it be understood to include *profit gained through a sale or conversion of capital assets*" (*Eisner* v. *Macomber*, 252 U. S. 189, 207), the analogy chosen was to tax the liquidating profit gained through conversion in the same manner as "other gains or profits" were already taxed under the 1918 Act.*

Significant is the fact that at the time of the Revenue Act of 1918 there was no provision in the law comparable to section 101 of the 1928 Act providing a special treatment for "capital net gains" and "capital net losses". Therefore, historically, the original provision in section

† See, for example, Treasury Regulations 45 promulgated under the Revenue Act of 1918, Section 201(c): "Art. 1548. *Distribution in liquidation.*—So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payments for the stock of the dissolved corporation. *Any excess so received over the cost of his stock* to the stockholder, or over its fair market value as of March 1, 1913, if acquired prior thereto, *is a taxable profit.* A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrrent return upon the stock."

*See Section 213(a) of the Revenue Act of 1918 defining "gross income". Section 213(a) of the Revenue Act of 1918 is comparable to section 22(a) of the Revenue Act of 1928 which is reproduced in the Appendix, p. 31.

201(c) of the Revenue Act of 1918: "Amounts distributed in the liquidation of a corporation *shall be treated as* payments in exchange for stock or shares, and any gain or profit realized thereby shall be taxed to the distributee *as other gains or profits*", has no relation whatsoever to the special treatment later accorded "capital net gains" and "capital net losses" in section 101 of the Revenue Act of 1928. It would, therefore, be unreasonable to construe the subsequently introduced section 101 dealing with only "sales or exchanges" as requiring a changed meaning for the already well-understood provisions of section 115(c), relating to the treatment to be accorded the conversion or liquidation of an existing investment. The governmental urge to have all transactions capital in nature treated as "sales or exchanges" runs afoul of the rule distinctly stated in *McFeely* v. *Commissioner*, 296 U. S. 102, 110, in construing section 101(c)(8) with section 113(a)(5):

> "The fact that the two sections deal with the same general subject—capital gains—is cited in support of the Commissioner's position that they ought to be consistently applied. There is, however, nothing novel in the naming of arbitrary 'basis' dates differing from the admitted dates of acquisition."

A liquidating distribution is a payment terminating the stockholder's proprietary interest or investment in the corporate enterprise. It is the consummation of the stockholder's right to a proportional part of the effects of the corporation when dissolved, after the payment of its debts. The effect is to wipe out the stockholder's interest in the corporation. The liquidation of the stockholder's proprietary interest through payment is a transaction capital in character rather than current or periodic.

The difference in character is what motivated Congress to accord a different treatment to "liquidating distributions" than accorded to ordinary or current dividend distributions. In *Hellmich* v. *Hellman*, 276 U. S. 233, it was decided, under section 201 of the Revenue Act of 1918, that the gain realized by stockholders upon the distribution in liquidation of the assets of a dissolved corporation was capital in character and taxable as "other gains or profits" under section 201(c) rather than a current "dividend" governed by section 201(a), even though the payment was made out of the corporation's accumulated earnings or profits:

> "* * * we think it clear that the general definition of a dividend in §201(a) was not intended to apply to distributions made to stockholders in the liquidation of a corporation, but that it was intended that such distributions should be governed by §201(c), which, dealing specifically with such liquidation, provided that the amounts distributed should 'be treated as payments in exchange for stock' and that any gain realized thereby should be taxed to the stockholders 'as other gains or profits.' This brings the two sections into entire harmony, and gives to each its natural meaning and due effect. The Treasury Regulations correctly interpreted the Act as making §201(a) applicable to a distribution made by a going corporation to its stockholders in the ordinary course of business, and §201(c) applicable to a distribution made to stockholders in liquidation of the corporation." [276 U. S. 233, 237]*.

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* The effect of this Court's decision was to settle the point that the gain or profit realized upon a stock investment at the time of the liquidation of a corporation was subject to tax both at the normal and surtax rates. Ordinary dividends were not subject to the normal tax but only the surtax.

Subsequently, when the sections of the Revenue Acts were renumbered in the Revenue Act of 1928 and the present order of sections adopted, section 201 became 115. Intrinsic evidence of the Congressional intent to preserve the historical relationship of liquidating profits to "other gains or profits" is found in the cross-reference contained in section 22 dealing with "Gross Income" made in subdivisions (d) and (e). Section 115(c) makes no reference to section 101 but makes specific reference to sections 111 and 112. On the other hand, at no place in sections 21, 22 or 23 or, for that matter, Part II of Subtitle B, is there any cross-reference to the provisions of section 101, although section 23 contains in subsections (h) and (i) cross-references to wash sales under section 118 and net losses of prior years allowed under section 117. Consequently, there is no intrinsic evidence that Congress intended a liquidating gain or loss which was not *in fact* a "sale or exchange" to be regarded as one under section 101.

V. The judgment rendered below is contrary to the provisions of section 23(e), the Court of Claims erring in making its opinion and judgment turn on a construction which ignored one of the three applicable sections.

A. Opinion Ignores Section 23(e).

Nowhere in the opinion below is there any consideration given to section 23(e) of the Revenue Act of 1928. This section, granting the petitioners a 100% deduction in unequivocal terms on their losses on their stock interests in Del-Bay Farms, Incorporated, has been ignored, the Court of Claims poising the construction problem as follows (R. 46):

> "The case turns on the construction of sections 101 and 115 of the revenue act of 1928 as applied to capital gains and losses."

This is the more surprising since under the special findings of fact No. 1 submitted by petitioners, it was found (R. 37-38):

> "* * * The issues to be determined by the Court are identical in the two cases, the chief of which is whether the loss for 1929 should be treated as an ordinary loss under section 23(e) of the Revenue Act of 1928 as claimed by plaintiff or as a capital loss under section 101 of the same Act as claimed by defendant."

B. Every Relevant Section Should Be Considered.

Petitioners are not advised by the opinion below why section 23(e) should not be considered; why the construction adopted should not at least attempt to harmonize all three provisions, sections 23(e), 101(b), and 115(c). See *Hellmich* v. *Hellman*, 276 U. S. 233, 237; *Kohlsaat* v. *Murphy*, 96 U. S. 153, at 159-160.

C. Relationship Between Sections 23 and 101 Established.

The statutory relationship between one of the subdivisions of section 23 and section 101 has been the subject of special consideration by this Court in *Helvering* v. *Bliss*, 293 U. S. 144, wherein it was unanimously held (p. 150):

> "By the express words of §23(n) charitable contributions are to be deducted to ascertain net income as defined in §21; and nothing in §101, which prescribes merely a method for segregating a portion of that net income for taxation at a special rate, in any

wise alters the right of the taxpayer to take the deduction in accordance with §23(n)."

This Court also took special pains to point out (p. 151):

> "Nor should the reduction in the rate of tax on capital gain, first granted in the Revenue Act of 1921, be held to circumscribe the privilege granted in the earlier Acts, and retained in later ones, with respect to charitable contributions, unless that result be plainly required by the language used."

No reason can be found why subdivision (e) of section 23 should not be accorded the same treatment as subdivision (n).

CONCLUSION

It is submitted that the decision by the Court of Claims below entirely ignores the full allowance of the petitioners' losses under section 23(e) and under the second sentence of section 115(c); that it is based upon a misconstruction of section 115(c) and an unwarranted broadening of the meaning of section 101 not justified by decisions of this Court. The judgments entered below should be reversed.

Respectfully submitted,

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October 28, 1938.

APPENDIX

Statutes Involved

REVENUE ACT OF 1928, c. 852, 45 STAT. 791

[Italics supplied]

TITLE I—INCOME TAX†

SUBTITLE A—INTRODUCTORY PROVISIONS†

* * *

SUBTITLE B—GENERAL PROVISIONS†

Part I—Rates of Tax

* * *

Part II—Computation of Net Income

"SEC. 21. NET INCOME.

'Net income' means the gross income computed under section 22, less the deductions allowed by section 23.

"SEC. 22. GROSS INCOME.

(a) General Definition.—'Gross income' includes *gains, profits,* and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades,

† A fresh start was made in preparing the Revenue Act of 1928. The explanation of the Committee on Ways and Means (Report, Committee on Ways and Means, No. 2, 70th Congress, 1st Session, p. 12) stated: "The bill embodies a proposed new arrangement for the income tax title. The basis for the arrangement is the distribution of the provisions by two classifications: General Provisions and Supplemental Provisions. There are a few Introductory Provisions. The General Provisions are those which apply to the ordinary transactions of the ordinary classes of taxpayers. It is be-

businesses, commerce, or *sales,* or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or *gains* or *profits* and income derived from any source whatever.

(b) Exclusions from Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * *

(d) Distributions by Corporations.—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

(e) Determination of Gain or Loss.—In the case of a *sale or other disposition* of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

* * * *

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions: * * *

(e) Losses by Individuals.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * *

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lieved that approximately 80 per centum of the taxpayers who file returns under the new Act will find in the General Provisions practically all the income tax statute law of interest to them. The General Provisions are divided into Parts. * * * In the main, the Supplemental Provisions are those which apply only to extraordinary classes of taxpayers or which apply only to the extraordinary transactions of ordinary classes of taxpayers. The Supplemental Provisions are divided into Supplements." To the same effect see Report, Senate Finance Committee (Report, Committee on Finance, No. 960, 70th Congress, 1st Session, p. 18).

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * *

(f) Losses by Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise,

(g) Basis for Determining Loss.—The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), shall be the same as is provided in section 113 for determining the gain or loss from the *sale or other disposition* of property.

* * *

SUBTITLE C—SUPPLEMENTAL PROVISIONS†

Supplement A—Rates of Tax†

[Supplementary to Subtitle B, Part VI]†

"SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) Tax in case of capital net gain. * * *

(b) Tax in case of capital net loss.—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a *capital net loss (as hereinafter defined in this section)*, there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

† See Congressional explanation footnote, p. 31, *supra*.

(c) Definitions.—For the purposes of this title—

• • • •

(2) 'Capital loss' means deductible loss resulting from the *sale or exchange* of capital assets.

(3) 'Capital deductions' means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets *sold or exchanged* during the taxable year.

• • • •

(6) *'Capital net loss'* means the excess of the sum of the *capital losses* plus the capital deductions over the total amount of capital gain.

(7) 'Ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) 'Capital assets' means property held by the taxpayer *for more than two years* (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. • • •

Supplement B—Computation of Net Income†

[Supplementary to Subtitle B, Part II]†

"SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) Computation of gain or loss.—*Except as hereinafter provided in this section,* the gain from the *sale or other disposition* of property shall be the excess of the amount

† See Congressional explanation footnote, p. 31, *supra.*

realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(b) Adjustment of basis.—In computing the amount of gain or loss under subsection (a)—

(1) Proper adjustment shall be made *for any* expenditure, *receipt,* loss, or other item, *properly chargeable to capital account,* and • • •

(c) Amount realized.—The amount realized from the *sale or other disposition* of property shall be the sum of any *money* received plus the fair market value of the *property* (*other than money*) received.

(d) Recognition of gain or loss.—In the case of a *sale or exchange,* the extent to which the gain or loss determined under this section shall be *recognized* for the purposes of this title, shall be determined under the provisions of section 112.

• • •

"SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) General rule.—Upon the *sale or exchange* of property the entire amount of the gain or loss, determined under section 111, shall be *recognized, except as hereinafter provided in this section.* [None of the exceptions except (g) can possibly be relevant.]

• • •

(g) Distribution of stock on reorganization.—If there is distributed, in pursuance of a plan of *reorganization,* to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, *without the surrender by such shareholder of stock* or securities in such a corporation, no gain to the distributee from the receipt of

such stock or securities shall be recognized. [This believed not applicable as there was no reorganization.]

* * *

"SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) Property acquired after February 28, 1913.—The basis for determining the gain or loss from the *sale or other disposition* of property acquired after February 28, 1913, shall be the cost of such property; except that * * * [None of the exceptions applicable].

* * *

"SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) Definition of dividend.—The term 'dividend' when used in this title * * * means any distribution made by a corporation to its shareholders, whether *in money or in other property*, out of its earnings or profits accumulated after February 28, 1913.

(b) Source of distributions.—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation *shall be treated as in full payment in exchange for the stock,* * * *. The gain or loss to the distributee resulting from *such exchange* shall be *determined under section 111, but shall be recognized only to the extent provided in section 112.* * * *"

REGULATIONS 74.

"ART. 625. **Distributions in liquidation.**—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. The phrase 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, by the complete retirement of all the shares of a particular preference or series, or by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of stock, whether or not pro rata among the shareholders.

The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and article 561, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113 and articles 591-604; but the gain or loss will be recognized only to the extent provided in section 112 and articles 571-580. Any gain to the shareholder may, at his option, be taxed as a capital net gain in the manner and subject to the conditions prescribed in section 101 and articles 501-503. In the case of amounts distributed in partial liquidation, other than a distribution in pursuance of a plan of reorganization as described in section 112(h), the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of section 115(b) for the purpose of determining the taxability of subsequent distributions by the corporation.

Example (1): A owns 10 shares of stock in the M Corporation for which he paid $1,250 in 1923. He receives in 1928 a dividend of $1,500 in complete liquidation. A is subject both to the normal tax and to the surtax upon his profit of $250 or at his option, in lieu of such taxes, to the tax upon capital net gain.

Example (2): A owns 10 shares of preferred stock and 10 shares of common stock in the M Corporation which he purchased in 1918 for $1,100 and $1,000, respectively. In 1928 the M Corporation has on hand $225,000 of capital, earnings and profits of $25,000 accumulated prior to March 1, 1913, and earnings and profits of $125,000 accumulated after February 28, 1913. The preferred stock is retired at $125 per share, $125,000 being used by the corporation for this purpose. A receives $1,250 in exchange for his 10 shares of preferred stock and is therefore subject to the normal tax and the surtax on $150, or at his option, in lieu of such taxes, to the tax upon capital net gain. The M Corporation then distributes a cash dividend of $25,000 on the common stock, which is subject only to the surtax. Without any further accumulation of earnings and profits, the M Corporation thereafter liquidates completely. A receives $2,250 in exchange for his 10 shares of common stock and is therefore subject to the normal tax and the surtax on $1,250, or at his option, in lieu of such taxes, to the tax upon capital net gain."